

# LP ALLOCATIONS

## Dry powder and diversity

Following a standout year of fundraising, **Tavneet Bakshi** and **Christian Allgeier**, partner and director at placement agent First Avenue Partners, respectively, offer insight on LP perspectives

Last year was a new record for private debt fundraising with a combined \$180 billion raised across 163 funds. The majority of this demand was driven by investors searching for higher risk-adjusted real yields, led by public and corporate pension funds, often with heavy consultant or gatekeeper involvement. Likewise, insurers continued to reallocate from traditional fixed income to private debt. All are seeking the panacea of an illiquidity premium.

Foundations, endowments, family offices and smaller institutional investors were also more active though most have newer credit programs and, as such, have often focused their attention on more vanilla strategies and backing more established GPs where they see less operational risks.

Parallel to increased investor demand, competition between GPs for capital has never been so high. We saw a marked uptick in the number of new GP entrants to this market, adding to established managers raising ever larger funds. Consequently, LPs are now more nervous of the sheer number of funds and amount of capital managers need to deploy. Slow deployment rates, yield compression and notable deal overlap across GPs have been common groans amongst LPs invested in this space, particularly at the larger end of the market. LPs are now far more selective. Although brand recognition, experience and a strong track record continue to be fundamental, differentiation is now key and increasingly difficult to find. GPs able to demonstrate differentiated origination and/or track records that stretch across market cycles stand out.



Christian Allgeier

We continued to see definitive regional trends from an allocation perspective. Investors from regions mired with low and stagnant yields – Japan, Germany, UK – remained big buyers of senior secured unlevered private debt strategies. In contrast we found that investors in the US expressed a far greater appetite for levered returns, typically from senior lending strategies. In many cases, we reviewed managers who were applying 2-3x fund level leverage and charging fees on gross assets. The money still came in.

US-based investors have also been ahead of the pack in the search for higher returning private credit strategies for their more mature debt programs. Asian – and to a lesser extent European – investors are now following their lead. Opportunistic credit has come to the forefront as investors seek diversification, typically to complement a direct lending exposure. We expect this trend to continue and to also

encompass demand for special situations and distressed strategies.

A plethora of asset-backed lending strategies have firmly taken their place within private debt allocations. From the more mainstream real estate and infrastructure debt opportunities to the niche areas like aircraft, shipping and trade, the drivers remain the same: stable yield, secured on tangible assets. LPs are also looking to diversify their corporate credit risk, especially at this point in the cycle. We expect this type of debt to weather well during the next down credit cycle.

Lastly, we found that investors expressed clear preference for US or pan-European strategies. While country-focused funds have been able to demonstrate differentiated deal flow and in some cases stronger pricing, these funds are often seen as too specific and remain difficult to place. The exception is the UK, which is the deepest lending market in Europe.

We believe that 2018 will continue to be a very strong year for private credit given the demand for higher yields. Clear GP leaders have emerged in both the US and Europe, and new GPs face an increasingly discerning LP audience. The need to differentiate will create further depth to this young asset class and will enable more diversified programs. Alongside a staple offering of direct lending strategies, investor appetite for shorter duration specialty lending strategies, asset-backed lending and stressed/distressed opportunities should all increase. The true test of the private credit market will be the next credit cycle downturn. The real GP winners will only be known then. ■